Report of the auditor-general to the Free State Legislature and the council on the Moqhaka Local Municipality

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Moqhaka Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.

2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Moqhaka Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practise (SA standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2017 (Act No. 3 of 2017) (Dora).

Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.

4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Material uncertainty relating to going concern

6. I draw attention to the matter below. My opinion is not modified in respect of this matter.

7. Note 52 to the financial statements indicates that the current liabilities exceeded current assets by R207 570 417 (2017: R134 909 475) and the municipality also owed Eskom R267 743 082 (2017: R210 676 280) at 30 June 2018, R226 318 356 of which was overdue for a period longer than 30 days. Furthermore, as reflected in note 15, trade payables from exchange transactions increased to R343 713 263 (2017: R259 132 464) as at year-end. These conditions, along with the other matters set forth in note 52, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Irregular expenditure

9. As disclosed in note 55 to the financial statements, irregular expenditure of R46 612 511 (2017: R33 897 608) was incurred, mainly due to non-compliance with supply chain management (SCM) requirements.

Unauthorised expenditure

10. As disclosed in note 57 to the financial statements, unauthorised expenditure of R146 419 880 (2017: R183 666 884) was incurred due to overspending of the approved budget.

Fruitless and wasteful expenditure

11. As disclosed in note 56 to the financial statements, fruitless and wasteful expenditure of R17 369 164 (2017: R12 811 907) was incurred mainly due to interest on arrear payments to creditors.

Restatement of corresponding figures

12. As disclosed in note 50 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of an error in the financial statements of the municipality, and for the year ended, 30 June 2018.

Material losses

13. As disclosed in note 54 to the financial statements, material electricity losses of R60 200 007 (2017: R51 137 515) were incurred, which represents 18,56% (2017: 16,29%) of total electricity purchased. Furthermore, material water losses of R19 717 718 (2017: R7 459 044) were incurred, which represents 30% (2017: 13%) of total water purified. The losses were mainly due to leakages, burst pipes, line losses, tampering and theft.

Material Impairments

14. As disclosed in notes 6 and 7 to the financial statements, consumer receivables were impaired by R418 346 919 (2017: R334 421 823) and assessment rates receivables were impaired by R18 652 559 (2017: R15 875 630).

Other matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Unaudited supplementary information

16. The supplementary information set out on page xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion on them.

Service delivery

17. The audit revealed areas of concern regarding poor planning and monitoring of infrastructure projects. The completion of these projects were often delayed, resulting in the quality of work being compromised while project costs were exceeded. This had a negative impact on the delivery of services as the funds were not always used effectively and efficiently to provide services and to achieve the desired impact of value for money as indicated by the matters below.

18. The municipality embarked on a project to upgrade all pump stations in Kroonstad, Viljoenskroon and Steynsrus. The project cost was R6 742 513. This project was initiated in order to upgrade several potable water pump stations in the municipality, as the existing infrastructure has become ineffective and problematic to maintain. The consulting engineer provided a practical completion certificate on 3 October 2018 which indicated that the pumps had been completed. However, during a site visit on 19 October 2018 it was identified that the pump station at Marais Street in Kroonstad was incomplete as the civil works were not completed and a new pump was not installed despite the project being certified as complete and the total amount quoted in the bill of quantities paid to the contractor. Furthermore, water disruptions originating from breakdowns or the inability of the existing pumps to cope with the demand, may pose a health risk to the community in the area.

19. The municipality planned an upgrade of the sewer treatment works, pond and filter in the Steynsrus area. Due to a budget shortfall, the municipality decided to reduce the scope of capital work and only do certain of the planned work for R13 156 520. The project commenced in July 2015, the practical completion certificate was issued on 7 July 2016 and the taking over certificate on 28 July 2016. The certificates issued were only for the civil works of the chlorine tank and settling tank. During a site visit on 19 October 2018, it was identified that some of the capital structures were incomplete and cannot be used as intended. Included in the amount of R13 156 520 is an amount of R4 034 434 for standing time which is regarded as fruitless and wasteful expenditure. Although the full amount was paid for the upgrading of the treatment works, it wil not be effective in the treatment of sewerage because certain of the required elements were not acquired and therefore will not achieve improved service delivery to the Steynsrus community.

20. During February 2009, the municipality constructed a paved road in the Snake Park residential area. The project was never fully completed due to a lack of funds and the contractor abandoned the project before it was completed. The amount included in the work-in-progress asset register was R6 096 825, which exceeded the contract amount of R4 088 025. When the site was visited on 19 October 2018, it was assessed that some of the completed sections of the paved road were vandalised and some of the block paved bricks were removed by residents as the project was never completed.

Responsibilities of the accounting officer for the financial statements

21. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and Dora and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

22. In preparing the financial statements, the accounting officer is responsible for assessing the Moqhaka Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

23. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

24. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

25. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected key performance areas (KPAs) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

26. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

27. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2018:

KPA	Pages in annual performance report
Basic service delivery	XX - XX

28. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

29. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA – Basic service delivery

Number of households without minimum sanitation standards (TL141)

30. The achievement for the target of number of households without minimum sanitation standards reported in the annual performance report was zero. However, the supporting evidence provided did not agree with the reported achievement.

Various indicators

31. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of the indicators listed below. This was due to the unavailability of listings to confirm that the targets were completely reported. The supporting documentation was also not signed to confirm that the reported measurements of actual roads gravelled or patched as indicated on the job cards were actually performed. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements in the annual performance report of the following indicators:

Indicator description	Reported achievement
Km gravel roads maintained and or re-gravelled – TL136	110 km
m^2 of potholes patched – TL 137	25 000 km^2
Kms of new paved roads to be built -– TL138	3 km
Kms of storm water drainages built, rehabilitated or replaced in addition to existing one – TL 139	2 km

Other matters

I draw attention to the matters below.

Achievement of planned targets

32. Refer to the annual performance report on pages XX to XX for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 31 of this report.

Adjustment of material misstatements

33. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the KPA - Basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

34. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

35. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

37. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.

Expenditure management

38. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.

39. Reasonable steps were not taken to prevent irregular expenditure amounting to R46 612 511 as disclosed in note 55 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The irregular expenditure was caused by the non-compliance with the SCM regulations mainly in respect of bids not advertised for the required period, deviations which did

not meet the requirements and minimum threshold of local content not specified in the tender specifications.

40. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R17 369 164, as disclosed in note 56 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The fruitless and wasteful expenditure was caused by interest on arrear payments to creditors.

41. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R146 419 880, as disclosed in note 57 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The unauthorised expenditure was caused by overspending of the votes in the approved budget.

Asset management

42. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

43. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.

44. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

45. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Procurement and contract management

46. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.

47. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1) and mainly related to grass cutting and hiring of trucks for refuse removal. Similar non-compliance was also reported in the prior year.

48. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2). Similar non-compliance was also reported in the prior year.

49. Bid documentation for procurement of commodities designated for local content and production, did not stipulated the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2).

50. In some instances, sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.

51. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

52. Awards were made to providers who were in the service of other state institutions or whose directors or principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44.

53. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest in contravention of SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

Other information

54. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and the selected KPA presented in the annual performance report that have been specifically reported in this auditor's report.

55. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

56. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPA presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

57. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

58. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

59. The leadership did not always take timely and adequate action to address weaknesses in the reporting on financial and performance management due to lack of monitoring and supervision,

which again resulted in material adjustments to the financial statements and annual performance report.

60. Management's controls on the reporting of performance information was not sufficient due to inadequate record keeping of supporting documentation relating to the reported targets.

61. The leadership's lack of accountability for sound financial management had a negative impact on the municipality's financial sustainability, overspending of the budget and irregular expenditure not being prevented.

62. Management did not ensure that internal control processes were adequately designed and implemented to ensure cost-effective procurement in certain instances and prevent non-compliance with SCM requirements. Management relied on internal control processes to ensure compliance with procurement requirements, but it is evident from the amount of irregular expenditure that these internal control processes were ineffective and subject to abuse.

63. Consequence management was not effective as the council did not investigate instances of unauthorised, irregular and fruitless and wasteful expenditure to determine whether any person was liable for the expenditure.

Auditor-General

Bloemfontein

30 November 2018

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected KPA and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:

   - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
   - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
   - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
   - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Moqhaka Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
   - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.